Wilsons

Farm Partnerships – Practice Notes

A series of eight practice notes for Practical Law written by

Jonathan Stephens, Partner
t: 01722 412 412
e: jonathan.stephens@wilsonslaw.com

Practice Note 3. – Dissolution and winding up – retirement and death

The series comprises:

1. Basic Principles
2. Who owns the business and assets?
3. Dissolution and winding up – retirement and death
4. How land can be owned and occupied in a partnership situation
5. Running the Partnership
6. Borrowings in Farm Partnerships
7. Tax
8. Limited Partnerships and LLPs

Reproduced from Practical Law with the permission of the publishers.
For further information visit www.practicallaw.com or call 020 7542 6664.

Farm partnerships: dissolution and winding up: retirement and death

- **Resource type: Practice note**
- **Status: Maintained**
- **Jurisdiction: England**

Farm partnerships: dissolution and winding up: retirement and death is part of a collection of eight practice notes on farm partnerships.

The third in the series, this note looks at the dissolution and winding-up of partnerships upon retirement and death of a partnership's partners. The note considers the different types of dissolution, what happens when a partner retires or passes away, planning for these situations in the partnership and improving certainty for continuing partners.

Jonathan Stephens, Wilsons Solicitors and Practical Law Agriculture & Rural Land

---

Contents

- Scope of this note
- Dissolution and winding up
  - Types of dissolution
  - Rights to require a dissolution
  - Dissolution on death
- Retirement or death
  - What usually happens in practice
  - Legal position
  - Option
  - Accruer
- Planning for retirement or death
- How to improve certainty for the continuing partners

Scope of this note

The third in the series, *Practice note, Farm partnerships: dissolution and winding up: retirement and death*, looks at the dissolution and winding-up of partnerships upon retirement and death of a partnership's partners. The note considers the different types of dissolution, what happens when a partner retires or passes away, planning for these situations in the partnership and improving certainty for continuing partners.

For further information on farm partnerships, see Practice notes:

- *Farm partnerships: basic principles (www.practicallaw.com/5-614-4486) .*
- *Farm partnerships: who owns the business and assets? (www.practicallaw.com/8-614-4507) .*

- *Farm partnerships: how land can be owned and occupied in a partnership situation (www.practicallaw.com/8-614-4526) .*
- *Farm partnerships: running the partnership (www.practicallaw.com/6-614-4527) .*
- *Farm partnerships: borrowings in farm partnerships (www.practicallaw.com/8-614-4531) .*
- *Farm partnerships: tax (www.practicallaw.com/6-614-4532) .*
- *Farm partnerships: limited partnerships and LLPs (www.practicallaw.com/4-614-4533) .*

Dissolution and winding up

Types of dissolution

A dissolution arises where the current partnership comes to an end. It may be a "technical dissolution", for example, where the death of a partner triggers a dissolution but the other partners in practice carry on a new partnership immediately afterwards. It may be a "general dissolution" with a final winding up of the business, whereby the assets are sold off and the business brought to an end.

In practice, a general dissolution may arise (or be threatened) as part of a partnership dispute. The potential consequences of this have to be kept in mind. The position on a dissolution is that any partner can require that all partnership property is sold and the partnership affairs wound up.

On a dissolution the court has a discretion to allow a minority partner to be bought out by the majority, where justice allows it, by way of a *Syers v Syers* order. This may avoid the need for a sale. If a sale is ordered, the partners may be given leave to bid for the assets provided that the sale is conducted by a third party.

Rights to require a dissolution

Partners can, in certain circumstances, apply to have the partnership dissolved. There are rights under *section 35* of the Partnership Act 1890 (PA 1890) to apply to court to do this, for example, if a partner is in wilful breach, or guilty of materially prejudicial conduct, or where it is just and equitable to do so.

A partnership agreement may also expressly allow a partner to require a dissolution in certain circumstances. An example would be where a partner has died and the continuing partners are not able to buy out his interests. Another may be where a partner is allowed to withdraw land he has introduced, and in doing so makes the business uneconomic.

Dissolution on death

Unless the partnership agreement states otherwise, or if there is no written agreement, the death of a partner will trigger a dissolution (see *Legal position*). In practice this may well result in a technical dissolution if all the parties agree, but otherwise a general dissolution could result.

For this reason, the partnership agreement will almost invariably provide for the partnership to continue on the death of a partner if there are two or more surviving partners.

It is also sometimes desirable to ensure that there are more than two partners in a partnership, so that there is no technical dissolution on the death of a partner. This can avoid a lot of uncertainty in administrative arrangements, such as banking and other arrangements that are registered in the name of the partnership.

Retirement or death

What usually happens in practice

It is not unusual, in the context of a family farming partnership, for succession on a retirement or death to be dealt with or varied by agreement between the parties, and often tax and financial planning plays a major role.

However, an understanding of the strict legal position is important. It forms the starting point for tax planning, and is the background against which the arrangements are made or negotiations take place. Also, it comes into sharp focus in the event of a dispute.

Legal position

If there is no partnership agreement, the death (or bankruptcy) of any partner dissolves the partnership (*section 33(1), PA 1890*). The remaining partners have authority to carry on the business for the purpose of winding it up (*section 38*).

This also applies if the partnership agreement fails to provide for the partnership to continue on the death of a partner. Also, if there are only two partners, the death of one will dissolve the partnership.

If a dissolution arises on a death, the personal representatives (PRs) of the deceased partner can require the partnership to be wound up and all the assets sold. The conduct of the winding up is vested in the surviving partners. The surviving partners have no inherent right to acquire the deceased partner's share.

Technically, the deceased partner's share in the partnership becomes a debt owing to his estate at the date of death (*section 43, PA 1890*). This is an unusual form of debt, as the estate is entitled to a share of any increase in value of the assets before sale, and must bear a share of any loss. *Section 42* gives the estate an option to require either a share of profits or interest on capital between the date of death and final payment.

The PRs of the deceased partner are in a difficult position. Almost always there is no desire to force a general dissolution and sale. In practice a deceased's interest in the business is often left in place for a period. This can result in the PRs becoming partners (at law) and hence personally liable for the debts and liabilities of the business. As an interim fix, the PRs can seek to join the partnership as limited partners.

The position is more difficult if any of the PRs are also partners in the business in their separate capacities, as they have conflicts of interest.

It is important to note that section 33(1) applies "subject to any agreement between the parties". In the absence of a written agreement there may be a verbal or implied agreement that can be demonstrated between the partners, and this can lead to disputes.

Where there are land capital accounts, the PRs of a deceased partner will have no right to recover the property itself, but only the value of it, unless special provision is made in the partnership agreement.

It seems that there may be a potential charge to stamp duty land tax (SDLT) where a partner dies having introduced land within the previous three years (see *Practice note, Farm partnerships: tax: Land as partnership property: SDLT (www.practicallaw.com/6-614-4532)*).

Option

It is common for a partnership agreement to set out an agreed option, on death or retirement, for the remaining partners to buy the retiring or deceased partner's share in the partnership. This is for a number of reasons:

- It ensures that the continuing partners have the right to acquire the partnership assets and continue the business (although this would not extend to assets held outside the partnership).
- ***Agricultural Property Relief* (*www.practicallaw.com/0-383-5823)*** or ***Business Property Relief* (*www.practicallaw.com/2-383-4498)*** is not available for inheritance tax purposes for any asset which is subject to an existing contract for sale (*sections 113 and 123, IHTA 1984*). An option to purchase does not have this effect (*HMRC: Inheritance Tax Manual: IHTM 25292*). It is important to check existing partnership agreements in this respect.
- Frequently, the option allows the continuing partners to pay over a number of years, with or without interest. This is intended to ease potential cash flow difficulties and enable the continuing partners to continue the partnership.

The first point to check is the circumstance in which an option applies, and the procedural aspects. Is it just on death, or wider? What are the time limits and other requirements for exercise?

The next question is whether the agreement spells out how the former partner's share is to be valued. This may be by revaluing the assets, or simply by reference to the values in the last balance sheet.

More often than not, options are never exercised and the matter is agreed between the continuing partners and family members. However, where there is no agreement the implications can be significant.

Where the agreement is silent on the matter of valuation under an option, there are cases going either way that can be argued (for example, *Cruickshank v Sutherland* for revaluation, *Re White* for book values). The point was considered again in *Drake v Harvey [2011] EWCA Civ 838*. This was a farming partnership case which, on its facts, came down on the side of book values. However, it underlined the point that a court will seek to ascertain what the parties intended by the words they used, having regard to the circumstances in which they made their agreement.

Ham v Ham [2013] EWCA Civ 1301 was slightly unusual in that it allowed termination of the partnership on three months' notice, with the partner receiving the notice having an option to be bought out at the "net value" of his partnership share. The Court of Appeal had some difficulty in determining what this meant, but came down on the side of current values rather than book values. For a discussion of Briggs LJ's comments in the case, see *Practice note, Farm partnerships: basic principles: Advising farming partnerships (www.practicallaw.com/5-614-4486)*).

It may be that an option should be drafted so that it ceases to apply in certain circumstances, such as where a nominated successor can be appointed, or where the deceased leaves his interest in the partnership to one or more of the other partners.

Following the Finance Act 2015 the existence of an option or accruer may prejudice an associated disposal for Entrepreneur's Relief in the context of a family farming partnership as a "partnership purchase arrangements".

Accruer

An accruer arises where, under the terms of the partnership agreement, a partner's interest passes

automatically to one or more of the other partners, usually on death or retirement.

Such provisions were used as an estate duty planning tool, whereby a parent's interest might pass to the next generation effectively by way of a tax-free gift, but such arrangements are now rarely encountered. There are specific inheritance tax rules that apply.

An accruer can be used instead of an option, with the continuing partners paying book value or market value for the outgoing partner's share. HMRC has confirmed that it does not view an accruer as creating an existing contract for sale so as to exclude APR/BPR (*HMRC: Inheritance Tax Manual: IHTM 25292*). Although an accruer has the advantage of creating certainty, it can put the continuing partners into a difficult situation as they are obliged to buy the interest at that price: an option gives more flexibility.

Planning for retirement or death

The position on a retirement or death should not be left as an afterthought in a farming partnership, especially where substantial value is held and there may be a significant revaluation surplus. Invariably things will depend on the family circumstances, including financial requirements of the older generation, ongoing viability of the business, the tax regime and (not least) the personalities involved.

Frequently, the farming members of the next generation will need to inherit sufficient assets and land in order to maintain the business. In the context of a family farming partnership the agreement will have to tie in with family wills and, where appropriate, trusts. Often, it is preferable to maintain flexibility in the longer term.

Points to consider include:

- How is a retiring partner to be provided for?
- How are the land and farming assets to pass to the next generation?
- Is an option or accruer appropriate?
- Should an option or accruer operate at anything other than market value?
- Should provision be made for nominated successors to be admitted to a partnership, or perhaps for the trustees of a deceased partner's will trust to be admitted?
- If partners have contributed land to be held as a partnership asset, via land capital accounts, should they (or their personal representatives) be able to extract the land on a death or retirement?

How to improve certainty for the continuing partners

In the context of a family farm, the next generation of farming partners may well be relying on inheriting partnership interests and land from the older generation.

If matters are not discussed and resolved within the family, claims may arise on the basis of proprietary estoppel, whereby (typically) the younger generation claims an interest in land on the basis of promises allegedly made by the older generation. Such claims tend to arise following a death, or as a result of a falling out between the partners.

An option or accrual provision ensures that the continuing partners can retain the partnership assets. However, in practice, they are often relying on receiving these from the older generation by way of gift rather than having to pay for them.

Many farming families are prepared to rely on each other to leave assets as they have said. However, there are a number of ways in which certainty could be improved:

- Contracting to leave assets by will. It is possible for an individual to undertake to leave his assets in a particular way in his will (see for example, *Ask, If a cohabitation agreement states that the parties hold as tenants in common but that in the event of one of their deaths their share passes to the other, does this defeat a will which states that the whole estate passes to a third party on death? (www.practicallaw.com/a-009-4222)*). This must be by way of a clear undertaking, not merely a statement of intent. In practice, a deed would be appropriate. Secondly, it must be in writing if it relates to land.

  This is probably suitable only in straightforward circumstances. It is inflexible, and difficulties could arise if circumstances change.

- Family charter. In the context of family companies, it is increasingly common for a family charter to be adopted setting out the principles of retaining ownership within the family, who may be employed, who may act as directors and so on. The same principle could usefully be adopted by a farming family, so that the intentions for the future are made clear. Such a family charter could potentially be relied on in a future estoppel claim. While it may not prevent such a claim arising, it should simplify a claim and make a compromise more likely at an earlier stage. That may well save the parties a very large sum in legal costs.

  A contract to leave farmland by will, or a family charter, does not prevent a promisor from dealing with the land. The position could be improved by the promisor putting in place an appropriate restriction or notice against the title at the Land Registry (see *Land Registry Practice Guide 19: Notices, restrictions and the protection of third party interests in the register (www.practicallaw.com/9-106-6726)*).

- In some circumstances, security for the next generation could be improved by adopting a different structure, perhaps granting a farm business tenancy to the partnership for an appropriate term. Thereafter, the right to continue farming is a separate issue to the ownership of the underlying freehold. Nonetheless, the next generation will still need sufficient capital to continue the business into the future. (See *Practice note, Family charters, Standard documents, Family charter: long form, with drafting notes* and *Family charter: short form, with drafting notes*.

Frequently, a farming family will review their wills at the same time as the partnership agreement. The solicitors involved may well act for all concerned, which is acceptable provided no conflict of interest arises or is likely to arise. The solicitor will be in considerable difficulty if a family member (at that time or subsequently) gives instructions to leave his relevant assets not as envisaged by the rest of the farming members; for example, to a non-farming member of the family, or to charity. Because of his duties of confidentiality, the solicitor would have to cease acting for all those who would be likely to be affected, and arguably could not tell any of them why.

Resource information

Resource ID: 0-614-4525

Products: Agriculture

This resource is maintained, meaning that we monitor developments on a regular basis and update it as soon as possible.

Resource history

Changes made to this resource

We will record here any changes to this resource as a result of developments in the law or practice.

Related content

Topics

Farm partnerships and farming agreements (http://uk.practicallaw.com/topic9-607-6428)

Practice notes

Farm partnerships: basic principles (http://uk.practicallaw.comtopic5-614-4486)

Farm partnerships: borrowings in farm partnerships (http://uk.practicallaw.comtopic8-614-4531)

Farm partnerships: how land can be owned and occupied in a partnership situation (http://uk.practicallaw.comtopic8-614-4526)

Farm partnerships: limited partnerships and LLPs (http://uk.practicallaw.comtopic4-614-4533)

Farm partnerships: running the partnership (http://uk.practicallaw.comtopic6-614-4527)

Farm partnerships: tax (http://uk.practicallaw.comtopic6-614-4532)

Farm partnerships: who owns the business and assets? (http://uk.practicallaw.comtopic8-614-4507)

©2015 Thomson Reuters. All rights reserved. Privacy Policy and Cookies(http://www.practicallaw.com/3-386-5597).Legal I
(http://www.practicallaw.com/8-531-0965). Subscription enquiries +44 (0)20 7202 1220 or email subscriptions@practicalla\
links to resources on our site (e.g. 2-123-4567) is to the PLC Reference ID. This will include any PDF or Word versions of a